City of Austin MEMORANDUM

Neighborhood Housing and Community Development Office
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Date: August 7, 2017

To: Mayor and City Council

From: Rosie Truelove, Interim Director, Neighborhood Housing and Community Development Department

Subject: Recommendations for Enabling the Creation of Accessory Dwelling Units

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This memo responds in part to Resolution No. 20160616-035, which, among other items, directs the City Manager to provide recommendations on new City programs that would help low/moderate income homeowners develop more on their property in order to stay in place, such as pre-approved design for accessory units or financial support for the construction of accessory units.

Much relevant analysis was conducted by Kevin Howard with the University of Texas Center for Sustainable Development and Nicole Joslin with the Austin Community Design and Development Center (ACDDC). In this memo, staff have summarized some of the major findings from three research articles written by Howard and Joslin (attached) and have identified additional actions required by City Council.

Should you have any questions, please contact Neighborhood Housing and Community Development staff: Lauren Avioli, Planner Senior, 512-974-3141, lauren.avioli@austintexas.gov; Regina Copic, Real Estate & Development Manager, 512-974-3180, regina.copic@austintexas.gov.

Financing for Accessory Dwelling Units

Issue: Accessory dwelling units (also called ADUs or "alley flats"[1]) can help low- to moderate-income residents build income and meet their property tax burden; however, these lower income residents who are most at risk of being displaced from their homes are unlikely to be served by private financing, due to lack of income, equity, or low credit scores. They are therefore often unable to secure the funding necessary to construct these units.

Recommendations for ADU Financing:

While there are existing City programs that could be used to finance income-restricted Alley Flat development, each of these comes with regulatory or policy restrictions that may not meet the needs of homeowners interested in constructing ADUs. For example, homeowners could apply to the existing Rental Housing Development Assistance (RHDA) program for funding; however, RHDA funds can only be spent on units restricted to residents at or below 50% of the median family income (MFI). The Austin Community Design and Development Center's Alley Flat Initiative, which partners with homeowners to construct alley flats, has stated that ADU rents can be restricted to a level affordable to an 80% MFI household, but any lower and the low- to moderate-income homeowner seeking to build the ADU will be unable to secure a loan or cover the costs of construction. Additionally, the RHDA program often requires a significant affordability period (between 15 and

[1] Alley flats are ADUs built to S.M.A.R.T. Housing and Green Building program standards and have 5-year affordability periods for residents at or below 80% of the median family income (http://thealleyflatinitiative.org/).

99 years depending on funding source). These long term affordability restrictions on ADUs can prevent the homeowner from realizing the ADU benefits that would allow them to stay in place, since they cannot collect as much income from rent as they would from a market-rate unit, nor may they be able to stay in the unit themselves, due to income restrictions on the ADU.

Housing Trust Fund (general fund dollars) and general obligation bond funding do not have this 50% MFI requirement or always require long term affordability, but these funding sources are already heavily utilized for other needs. Further discussions about trade-offs would need to occur at the policy level if funding were to be set aside for ADU construction.

Staff and stakeholders have identified the need to update the S.M.A.R.T. Housing policy to provide incentives and requirements that are tailored to smaller projects, including ADUs. As currently proposed in the CodeNEXT draft released in June 2017, the S.M.A.R.T. Housing policy would require that affordable rental units be set aside for households at or below 60% MFI for 40 years; however, as described above, the Alley Flat Initiative's model works best when homeowners are able to provide ADUs at 80% MFI for shorter periods of affordability (ex. 5 years).

Further, additional incentives beyond expedited review and fee waivers for permitting/review would be needed because the smaller scale development process for ADUs means that these incentives are less valuable for ADU development than for development of larger scale projects. Additional incentives should be explored including potential cost sharing for required infrastructure upgrades, or City tax abatements for property owners. These policy updates will continue to be a part of the S.M.A.R.T. Housing update discussion through CodeNEXT.

Construction of ADUs

Issue: Current development regulations can add more time, cost, and design burdens to a project.

Recommendations for Facilitating Construction of ADUs:

The CodeNEXT process seeks to address many of the challenges associated with the development process in general and the development of ADUs in particular. However, the following strategies should also be considered to further facilitate development of ADUs:[2]

- Establish a mechanism to create pre-approved design standards for ADU or alley flat construction (such as these, created by the Alley Flat Initiative: https://issuu.com/acddc/docs/031317_afcatalog_v4.22);
- Allow more flexible placement of ADUs on a parcel – setback requirements and placement requirements in draft transect zones are very restrictive and may prevent ADUs from being built on lots with existing single family homes that do not conform to the new code's building placement requirements;
- Allow income-restricted ADUs to have gross floor areas of 1,100 square feet as allowed in the current code. The draft code constrains ADUs to 672 square feet, which would make construction of a single story 2-bedroom unit extremely difficult. Remove restriction in draft code that ADUs must be narrower than the primary structure; this restriction could prevent ADUs from being constructed on lots with narrow homes.
- Remove draft code requirement that all ADUs must have restrictive covenants dealing with owner occupancy and subleasing on file with the City – this would further constrain a property owner's ability to construct ADUs and utilize them to stay in place.

[2] These recommendations have also been forwarded to the CodeNEXT team to inform the creation of the next code draft in a memo from Neighborhood Housing to the Planning & Zoning Department dated June 7, 2017.

- Allow interior ADUs wherever accessory apartments are permitted. There is currently no option for interior ADUs in the draft code, although the Strategic Housing Blueprint calls for relaxing regulations on both interior and exterior ADUs. (CodeNEXT comments provided by the Austin Housing Coalition [http://austintexas.gov/sites/default/files/files/Planning/CodeNEXT/AHC_CodeNEXT_Affordability_Commets.pdf] also suggest that age and disability restrictions on occupants of internal/attached ADUs should be removed to enhance the availability of affordable housing across the city.)

Case Studies

Jake Wegmann, Assistant Professor in the School of Architecture at the University of Texas, and his Community and Regional Planning (CRP) students, conducted a study assessing ways to finance ADUs.[3] Their conclusions are similar to ACDDC's recommendations; however, they also include case study references indicating how other cities encourage ADU development through financing and more relaxed requirements. The most common tools include relaxing or removing parking requirements and requirements that the owner live on the property. Common tools to finance ADUs include City-operated loan programs and fee waivers to help lower construction costs and keep the unit affordable over time.

Vancouver, British Columbia, Canada

- Changed to no longer require off-street parking
- Changed to not require the owner to live on-site
- Single-family lots may include both Attached Accessory Dwelling Unit and Detached Accessory Dwelling Unit
- Raised the occupancy limits for dwellings
- Relaxed building requirements (size, height, and placement of ADUs)

Santa Cruz, CA

- Established an affordable housing program for ADUs
- Two-part program: Fee waivers and loans
- The homeowner can receive fee waivers in exchange for keeping the unit affordable at a specified MFI level
- The loan program services low-income homeowners at 80% of the area median income or below
- Under the loan program, the unit must be kept affordable for 15-20 years
- The loan program was a partnership between the City, a non-profit and a credit union

Attachments

cc: Elaine Hart, Interim City Manager
Bert Lumbreras, Assistant City Manager
Greg Guernsey, Director, Planning and Zoning Department

[3] Community and Regional Planning Program (CRP) Students at the University of Texas. "Strategies to Help Homeowners Finance Accessory Dwelling Units in Austin," May 20, 2016.

MISSING MIDDLE HOUSING IN AUSTIN, TEXAS

Austin Community Design and Development Center
University of Texas Center for Sustainable Development

Kevin Howard, UT
Nicole Joslin, ACDDC

May 2016

ACDDC
Austin Community Design and Development Center
Design Matters

Background

Missing middle housing typologies have become a major topic of discussion in the Code NEXT land development code re-writing process in Austin due to their promise to increase options for affordable housing in the city. Missing middle housing types include accessory dwelling units, bungalow courts, duplexes, four-plexes, and small apartment buildings which allow a greater number of people to share land cost in structures that are compatible with the neighborhood character in existing residential neighborhoods.

These housing types offer a greater variety of housing options within residential neighborhoods at significantly lower cost per-unit than single-family housing. Medium density residential development directly addresses the primary drivers of housing costs by allowing reduced per-unit land costs while keeping per-unit construction costs low. Missing middle housing types take advantage of Type V construction keeping per square foot unit construction costs similar to single-family construction. While single-family housing is no longer affordable in central Austin due to high land costs, higher density missing middle housing types allow more households to share the cost of land, reducing each household's share of land costs. Additionally, this range of housing types offers potential for increased housing options with close proximity to transit and urban amenities, allowing residents to decreased their reliance on private automobiles and reduce their household transportation costs. When allowed by local development code, reduced requirements for on-site parking reduce construction and development costs, further bringing down the cost of housing for homeowners and renters.

However, Austin's current development regulations impose significant barriers to the development of missing middle housing types. Although the scale of missing middle housing types is comparable to single-family homes, most of these housing types are regulated like large-scale commercial developments. Regulatory impediments range from administrative barriers to unnecessarily burdensome site design requirements including: site design review, large minimum site areas, density limitations, and compatibility requirements. These regulatory impediments disadvantage new infill affordable housing development and reduce the number of moderately priced housing options available in the city. Additionally, these regulations unnecessarily inflate the development costs of the missing middle housing products that are built, increasing the eventual sales and rental prices to residents.

Barriers

Site Plan Review

One of the major impediments to the development of missing middle housing types in Austin is commercial plan review. All projects, three units and greater, are required to undergo commercial plan review, which increases the administrative, design, and carrying costs for missing middle housing projects including bungalow courts, row houses, four-plexes, and small apartment buildings.

First, commercial plan review approximately doubles the length and complexity of the permitting process when compared to residential review. Commercial plan review typically requires a full set of civil engineering drawings and separate city staff review processes for building permits and site plan, lengthening the overall permitting process to about six months. Developers are often forced to satisfy city staff from multiple departments with competing requirements. Residential review on the other hand, does not require a separate site plan review process or civil engineering drawings and is

often completed within three months. Property owners pay debt service on financing for acquisition and design fees through the review process. A longer review process increases the administrative costs and financing costs on missing middle housing development projects.

Second, by increasing a project's design and administrative costs, commercial plan review creates a substantial burden on potential small-scale missing middle projects when compared to both single-family and large-scale apartment developments. Commercial plan review increases the design costs for any missing middle housing type with greater than three units. In ACDDC's experience, hiring a civil engineer to complete the drawings required for site plan review increases design cost between $20,000 and $30,000 for a medium sized infill site. Also, the added complexity in getting a missing middle development permitted increases the man-hours required and the overall costs to manage the project. This administrative burden alone is a significant disincentive to property owners pursuing small-scale projects. Missing middle housing developments are likely to require a similar investment of labor from the property owner as would an apartment development with over 100 units. However, small-scale projects produce a substantially lower return on investment to a property owner than large-scale projects. Alternatively, a project that replaces an existing home with a single-family luxury-home is likely to require significantly lower administrative and design costs because it is not required to endure a commercial plan review.

The increased project costs that missing middle housing developments incur due to commercial plan review inflates a project's overall development cost. In market rate units, higher development costs are passed down to residents through increased sales or rental prices. In subsidized projects, higher per-unit development cost decreases the number of low-income households that can be served by non-profit housing providers.

Lot Size and Minimum Site Area Requirements

Minimum lot size requirements and minimum site area requirements in multifamily zoning districts are not suited to missing middle housing development. All multifamily zones require a minimum lot size of 8,000 square feet. This requirement prohibits the incremental densification of urban neighborhoods and is inappropriate for many missing middle housing types. For example, triplexes and four-plexes with moderately sized units can readily fit on a standard single-family lot. Requiring these housing types to be built on an 8,000 square foot lot unnecessarily increases the per-unit cost of land, artificially inflating the cost of the unit.

Minimum site area requirements specify the minimum lot area required per housing unit. This regulation is effectively a density cap, limiting the number of units allowed to share the cost of land in multifamily zones. Minimum site area requirements are overly restrictive and encourage the creation of larger unaffordable units. As property owners are generally inclined to maximize the potential of their site by building to the highest and best use. In a housing market like Austin's where there is a distinct shortage of housing, multifamily developers are incentivized to maximize rentable or "for sale" buildable square footage. Due to minimum site area requirements, this often means that fewer housing units will be built with larger unit sizes. This increases per unit cost of land and construction costs reducing the affordability of housing units in multifamily zoning districts. Alternatively, missing middle housing types could potentially be built at densities as high as 50 units per acre at a low-rise scale compatible with single-family neighborhoods. Minimum site area requirements limit the feasibility of missing middle housing developments and artificially drive up the cost of housing in multifamily zones.

Compatibility

While the City of Austin regulates residential development compatibility through the McMansion ordinance, most missing middle housing types are required to comply with much more burdensome commercial compatibility requirements. If a site is commercial or multifamily and is within 540 feet of a lot with a single-family or duplex use, the development must comply with commercial compatibility requirements. These requirements supersede base zoning codes and increase setbacks, reducing allowable height, add additional constraints to site design, as well as a series of additional regulations including screening, lighting, and placement of dumpsters.

Building Setbacks and Height Limits

While each lot's base zoning district places predictable regulations to development, compatibility standards, triggered by neighboring uses, further reduce the development potential of a site. According to base zoning site development regulations, multifamily zones are generally allowed to build five feet higher than lots zoned single-family. Single-family lots are also required to be setback an additional ten feet from the street. The major difference between each of the zones is the amount of building coverage and impervious surface cover that is permitted on the site (Figure 1).

Site Development Regulations

	SF-2	SF-3	MF-2	MF-3	MF-4	MF-5
Min Lot Size	5,750	5,750	8,000	8,000	8,000	8,000
Min Lot Width	50	50	50	50	50	50
Max DU	7.6	15	23	36	54	54
Max Height	35	35	40	40	60	60
Min Setbacks						
Front	25	25	25	25	15	15
Street Side Yard	15	15	15	15	15	15
Interior Side Yard	5	5	5	5	5	5
Rear Yard	10	10	10	10	10	10
Max Building Coverage	40%	40%	50%	55%	60%	60%
Max Impervious Cover	45%	45%	60%	65%	70%	70%
Max FAR				0.75:1	0.75:1	1.00:1

Source: § 25-2-492 - Site Development Regulations. | City of Austin Code of Ordinances

Figure 1: City of Austin Site Development Regulations

Residential and commercial compatibility requirements have the same intended purpose: to minimize the impact of new construction on existing residential neighborhoods. However, the disparity between the compatibility requirements constitutes a double standard that discriminates against more affordable housing types regardless of the form of development. In fact, a residential project with three or more units would be required to be smaller in every dimension than a project with one or two units constructed on the same lot. While residential compatibility standards adds setback planes to the base zoning regulations, requiring new housing to step back from the side and rear property lines (Figure 3), commercial compatibility requirements require a more aggressing setback plane as well as increased front, side, and rear setbacks. Commercial compatibility standards vary by site area, width, and street frontage and also include a list of rigid site design limitations including parking and driveway setbacks (Figure 3 and 4). Although concessions for small sites are built into Austin's commercial compatibility

standards, the small lot compatibility standards continue to place unnecessary burden on small multifamily projects like missing middle housing types.

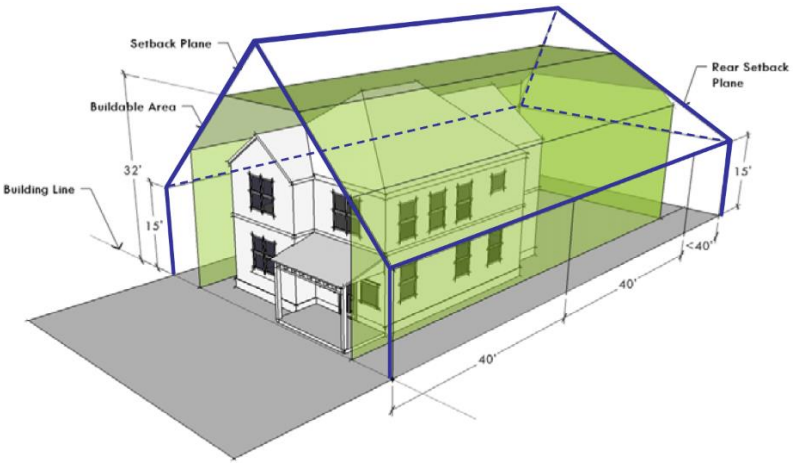


Figure 2: Residential Compatibility- Tent and Buildable Area

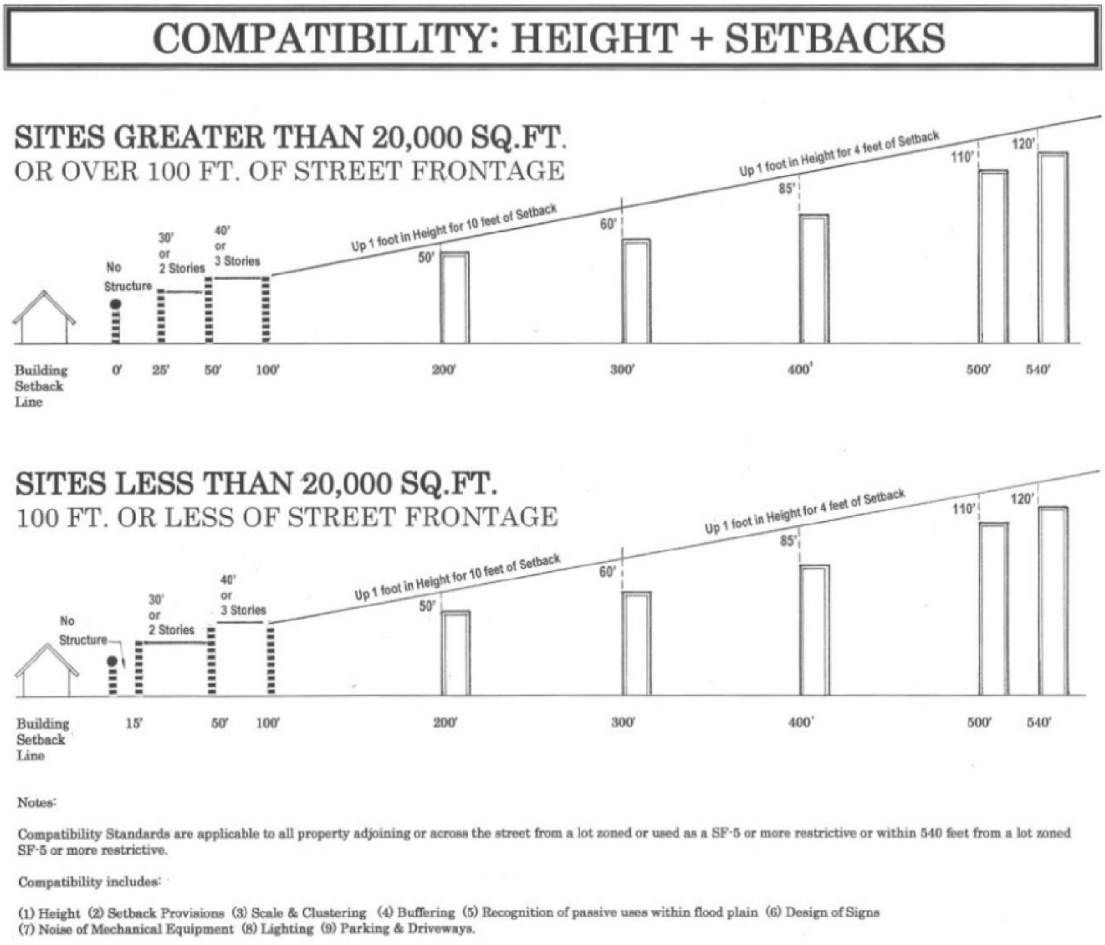


Figure 3: Commercial Compatibility- Height and Setbacks (City of Austin LDC)

Commercial Compatibilty

Setbacks

Length of Street Frontage (Feet)	Side and Rear Setback (Feet)	Front Setback (Feet)
52.51 to 54.99	15.5	25
55.00 to 57.50	16	25
57.51 to 59.99	16.5	25
60.00 to 62.50	17	25
62.51 to 64.99	17.5	25
65.00 to 67.50	18	25
67.51 to 69.99	18.5	25
70.00 to 72.50	19	25
72.51 to 74.99	19.5	25
75.00 to 77.50	20	25
77.51 to 79.99	20.5	25
80.00 to 82.50	21	25
82.51 to 84.99	21.5	25
85.00 to 87.50	22	25
87.51 to 89.99	22.5	25
90.00 to 92.50	23	25
92.51 to 94.99	23.5	25
95.00 to 97.50	24	25
97.51 to 99.99	24.5	25
>= 100	25	25

Source: §13-2-738 City of Austin Code of Ordinances

Parking Design

Total Site Width	Avg. Parking Width	Setback for Parking	Setback for Driveways
0 to 52.99′	45′	5′	0′
53 to 55.99′	46′	6′	1′
56 to 58.99′	47′	7′	2′
59 to 61.99′	48′	8′	3′
62 to 64.99′	49′	9′	4′
65 to 67.99′	50′	10′	5′
68 to 70.99′	51′	11′	6′
71 to 73.99′	52′	12′	7′
74 to 76.99′	53′	13′	8′
77 to 79.99′	54′	14′	9′
80 to 82.99′	55′	15′	10′
83 to 85.99′	56′	16′	11′
86 to 88.99′	57′	17′	12′
89 to 91.99′	58′	18′	13′
92 to 94.99′	59′	19′	14′
95 to 97.99′	60′	20′	15′
98 to 100.99′	61′	21′	16′
101 to 103.99′	62′	22′	17′
104 to 106.99′	63′	23′	18′
107 to 109.99′	64′	24′	19′
110 to 112.99′	65′	25′	20′
113 to 115.99′	67′	25′	21′
116 to 118.99′	69′	25′	22′
119 to 121.99′	71′	25′	23′
122 to 124.99′	73′	25′	24′

Source: §13-2-738 City of Austin Code of Ordinances

Figure 4: Commercial Compatibility Site Design Requirements

Parking

Commercial compatibility standards for parking setbacks effectively reduce unit size and drive up per-unit construction costs on small-lot multifamily projects. Increased side and rear parking setbacks force on-site parking and housing to compete for the same limited lot space. This forces a compromise in site design trading rentable square footage for parking spaces. Overall, this forces units to be significantly smaller. In order to take advantage of limited developable space, property owners are likely to accommodate the required on-site parking using a tuck-under design. While this solution is far cheaper than building a parking podium, according to estimates from staff at Momark Development,

each tuck-under space adds approximately $6,500 to the projects construction costs. This would increase the hard cost of a two-bedroom unit by approximately $13,000 dollars[1].

Other Requirements

While one and two unit residential project are regulated by clear and measurable articulation standards through the McMansion Ordinance, missing middle projects are subjugated to subjective design requirements. § 25-2-1065 – Scale and Clustering | City of Austin Land Development Code uses the phrases “variety of scale relationships”, “appearance or feeling of a residential scale”, and “human scale” to describe how applicable multifamily properties must be designed to comply with compatibility requirements. This subjective language creates a lack of predictability for property owners and designers, complicating the review process and increasing the risk of investing in missing middle housing projects.

Regardless of the scale of development, multifamily properties are also subjected to a long list of compatibility requirements unknown to single-family projects including limitations to lighting, noise, reflective surfaces, and placement of dumpsters and recreational uses. While it is not unreasonable to regulate these project elements, there is no reason that small multifamily projects should be forced to conform to a different set of standards than their single-family neighbors.

Affordable Four-plex Missing Middle Case Studies: 2905 Khulman and 1126 Chicon

In order to better understand the impact of compatibility requirements on the ability to create affordable missing middle housing in Austin’s central neighborhoods, this case study explores two potential non-profit four-plex projects. Blackshear Neighborhood Development Corporation (BNDC) approached ACDDC expressing interest in developing four-plexes on two different lots owned by BNDC. A brief feasibility study for these two properties revealed considerable obstacles to the development of moderate density affordable housing and apparent disparities between the way the city regulates the development of single-family development and more affordable missing middle housing types. Each site was tested for how it might accommodate a four-plex development under both commercial compatibility requirement and residential compatibility requirements (also referred to as the McMansion ordinance).

Both sites are located in residential neighborhoods in East Austin in close proximity to emerging neighborhood centers and higher density residential development. 1126 Chicon is currently zoned MF-4 and is designated by the Rosewood Neighborhood Plan future land use map to be multifamily. However, the site is 7,095 square feet and therefor considered a substandard multifamily lot. 2905 Khulman is currently zoned SF-3 but is 9,050 square feet and therefor large enough to be considered for up zoning to multifamily zoning. It is located near the Austin Community College Eastview campus and emerging neighborhood center located at the intersection of Pleasant Valley and Webberville. Both sites are surrounded on all sides by single-family residences, requiring a four-plex development to conform to commercial compatibility standards.

[1] Howard, 2016, Sustainable Growth and Affordable Form: Strategies for Austin’s Future Housing Development

Figure 5: 1126 Chicon Neighborhood Context

Figure 6: 2905 Khulman Neighborhood Context

Two schematic designs were prepared for each site, one using residential compatibility standards, and the second, using the required commercial compatibility requirements. The primary goal driving each site design was to accommodate the required on-site parking while providing four family-sized units. On-site parking requirements were designed to conform to City of Austin requirements within the urban core (Figure 7). These designs attempt to produce the largest units probable given the site constraints and compatibility requirements. Vertical circulation was included in the square footage of the units on the upper floor. The site plans illustrate that each unit has a separate exterior entrance. However, each of the designs could readily be adjusted to use a communal stair for the upper units, improving the design's spatial efficiency. Ground oriented unit designs were used to strengthen the individuality and identity of each home.

City of Austin On-site Parking Requirements

Bedrooms	Spaces
0	1
1	1.5
2	2
3	2.5
+1	0.5*

*each additional bedroom

Figure 7: City of Austin On-site Parking Requirements

There was a substantial difference in the amount of development allowed under residential compatibility standards and commercial compatibility standards in both case studies. In the Chicon example, commercial compatibility requirements reduced the total floor area ratio (FAR) from 0.62 to 0.43, or almost 1,300 square feet. In the Khulman example, the total FAR was reduced from .56 to .41, or about 1,100 square feet. In both of these cases, reducing buildable square footage removed the possibility of providing four family-sized units. Rather, two family-sized units and two small one-bedroom units could be built on each site due to parking space requirements and setbacks and development setbacks. Additionally, both designs under the commercial compatibility standards required about half of the parking lot be built under the second floor units, increasing construction costs.

Overall, commercial compatibility setbacks forced the four-plex structures to be very narrow. On narrow sites like those studied in this report, these setbacks force the structure to take on awkward proportions. This can be seen in the Chicon example where although the lot is 55.5 feet wide, the structure is forced to be less than 23.5 feet wide in order to allow for a driveway and comply with setback requirements. While narrow structures like this have been used for centuries on narrow lots, these structures are not compatible with the proportions of wide lot neighborhoods.

Parking setbacks built into the commercial compatibility standards force narrow lots to build tuck-under parking. While the residential compatibility regulations allow parking to be accommodated efficiently on surface parking, commercial compatibility parking setbacks force parking spaces to

compete with buildable area. In order to accommodate parking on the site far enough away from the side and rear property lines, both the Chicon and Khulman designs were forced to build tuck-under parking. This is likely to increase the total construction cost by approximately $26,000[2].

All units were forced to be smaller using the commercial compatibility standard. Each unit on the second floor of the Chicon design were reduced by 108 square feet from the design using residential compatibility requirements. The ground floor units on the other hand were reduced from two bedroom, two bathroom units larger than 1,000 square feet to one-bedroom, one-bathroom units of approximately half the size. In the Khulman design, upper floor units remained mostly the same while the ground floor units were cut in half.

In the cases of 1126 Chicon and 2905 Khulman, commercial compatibility requirements likely increased the per-unit construction cost while reducing amount of development on the site and the ability of BNDC to serve low-income families. The site design using the residential compatibility requirements show that more permissive standards like those used on one and two family residences are better suited to small lot missing middle housing types like four-plexes, while commercial compatibility requirements forced illogical compromises in the site design.

[2] Howard, 2016, Sustainable Growth and Affordable Form: Strategies for Austin's Future Housing Development

1126 Chicon

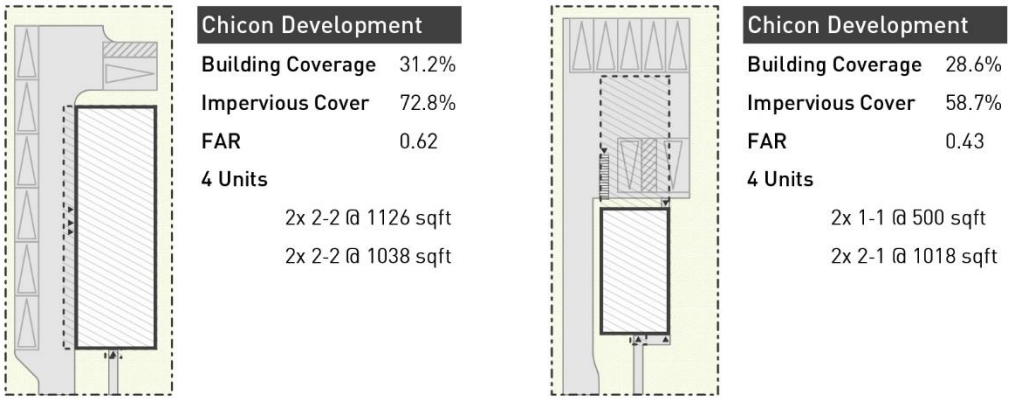
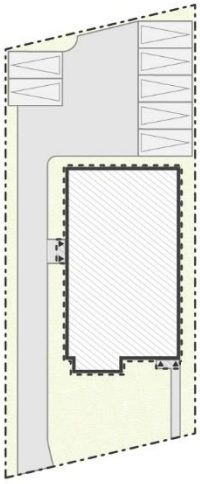


Figure 8: 1126 Chicon Comparative Site Plans

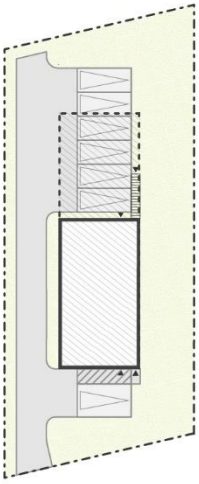
1126 Chicon

Figure 9: 1126 Chicon 3D

2905 Khulman



Khulman Development	
Building Coverage	28.1%
Impervious Cover	68.2%
FAR	0.56
4 Units	
	2x 2-2 @ 1175 sqft
	2x 2- @ 1230 sqft



Khulman Development	
Building Coverage	25.8%
Impervious Cover	52.6%
FAR	0.41
4 Units	
	2x 1-1 @ 682 sqft
	2x 2-2 @ 1167 sqft

Residential Compatibiltiy | Commercial Compatibiltiy

Figure 10: 2905 Khulman Comparative Site Plans

2905 Khulman

Residential Compatibiltiy | Commercial Compatibiltiy

Figure 11: 2905 Khulman 3D

Conclusion

As land values increase in central Austin neighborhoods, the ability to increase density will become essential to keeping these neighborhoods affordable. Missing middle housing types offers a solution to increase the diversity of housing and availability of lower cost housing while maintaining the human-scale of Austin's central neighborhoods. However, Austin's current development regulations categorize small-scale multifamily development the same as it would a strip mall or 100-unit apartment complex. This misclassification disincentives missing middle housing projects by submitting them to rigorous and illogical regulation driving up development costs and reducing development potential. Commercial plan review increases administrative, design, and carrying costs for projects greater than three units. Minimum lot area requirements require too much land, while minimum site area requirements limit density far below the capacity of many missing middle housing Types. Additionally, compatibility requirements place a host of restrictive standards on projects with greater than three units while one and two-family residences are allowed to build larger and have fewer site design limitations. While residential and commercial compatibility requirements have the same intended purpose, the 1126 Chicon and 2905 Khulman case studies highlight how these regulations form a double standard that discourages small-scale multifamily projects by decreasing development potential well below that of a single-family home.

The current regulations have a systemic bias toward single-family housing. In central Austin, single-family homes have increasingly more expensive and far out-of-reach for the working class and much of the middle class. As Austin's economy continues to grow the City's regulatory bias toward single-family housing will promote exclusivity in Austin's central neighborhoods and exacerbate economic and racial segregation. However, it is not necessary for Austin's neighborhoods to forfeit their charm and residential scale to accommodate more affordable housing types. Many missing middle housing types are compatible in form and use to single-family neighborhoods. Simply regulating these small-scale, more affordable housing types using the same standards as single-family properties would remove many of the barriers preventing the construction of affordable neighborhood-scale housing. Small multifamily projects like four-plexes and cottage courts could be reviewed using the same review process as single-family projects rather than forcing them to go through commercial plan review. Austin's new land development code, known as Code NEXT, can and should allow for more missing middle housing types in the city however, removing regulatory barriers to these housing types requires addressing administrative processes as well as development code. Missing middle housing types are readily built to fit in the context of existing single-family neighborhoods and it is inappropriate to apply regulations designed for large scale multifamily and commercial developments to small infill sites best suited for missing middle housing types.[3]

[3] The FHA currently provides financing for owner-occupied projects with up to four units with low interest rates and as little as 3.5% down. The city could build the land development code to take advantage of this system, encouraging local investment and community development from small-scale neighborhood oriented property owners rather than corporate developers.

ALLEY FLAT FINANCING STRATEGIES

Austin Community Design and Development Center
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ACDDC
Austin Community Design and Development Center
Design Matters

Introduction

Austin's service workers, critical workforce and their families are increasingly being pushed out of central neighborhoods by rising rents and rapidly increasing property tax bills. Developing affordable rental Alley Flats offers the potential for low and moderate-income homeowners to share their property tax burden and increase their household income, empowering them to stay in their communities and take part in the city's growing economy. However, the residents most at-risk of being displaced from their communities are unlikely to be served by private financing. There are substantial opportunities for charitable organizations, innovative finance institutions, and public entities to fill this gap.

The Austin Community Design and Development Center and the University of Texas Center for Sustainable Development conducted a series of investigations into the potential financing strategies available to construct Alley Flats in Austin. Financing has been a persistent barrier to building green, affordable accessory dwelling units and is an issue that must be addressed if Alley Flats are to be a feasible option for homeowners in Austin. This research included an evaluation of traditional financing mechanisms offered through private lending intuitions, the potential for program related investments from charitable organizations, and potential public funding strategies. The following is a summary of the challenges faced and strategies explored through this partnership. We hope that this may serve as a stepping stone to the building of partnerships and thought leadership that will lead to the realization of a feasible, actionable financing program for Alley Flat development in Austin and other similarly situated cities across Texas.

Housing Unaffordability in Austin, TX

In many central Austin neighborhoods, especially in East Austin, a growing population and economy have strained the existing housing stock. Austin's service workers, critical workforce and their families are increasingly being pushed out of central neighborhoods by rising rents and rapidly increasing property tax bills.

While the city has increased its efforts to promote the *creation* of affordable rental housing, there remains an enormous shortage of units affordable to low and moderate-income households in Austin. The 2014 City of Austin Comprehensive Housing Market Study estimates a shortage of 48,000 rental units affordable to households making less than $25,000 annually and 10,660 units affordable to households making less than $35,000 annually.

From 2000 to 2012 median home values in Austin have increased 78% with the historically segregated minority communities in central East Austin increasing the most. Homes in zip code 78702 increased on average 207% between 2000 and 2012. Along with higher property values, property taxes have increased relentlessly. Between 2008 and 2015 the average Austin homeowner saw their tax bill increase 40% (Texas Public Policy Foundation).

Increasing tax burden has caused massive displacement of long-time residents especially in central East Austin neighborhoods. In 2012, The Land of Broken Dreams Report from PODER and the East Austin Conservancy reported that 1/3 of long term residence in the East Austin neighborhoods of Rosewood, Chestnut, East Cesar Chavez, and Holly (all within the 78702 zip code) no longer own their homes and a significant portion of the remaining long term homeowners had tax delinquencies.

In the State of Texas, a restrictive legislative climate limits the City of Austin's tools for *preserving* affordability for its existing long-term residents. While a greater effort is essential to increase the number of affordable rentals in in the city, *preserving* affordability for existing residents rooted in their communities will require intervention from socially driven investors.

Alley Flat Initiative

At the Alley Flat Initiative, we work to make sustainable, green, and affordable accessory dwelling unit (ADU) development attainable for all homeowners. An ADU is a small-detached house built in the backyard of a single-family lot. An Alley Flat is distinguished as a green, affordable ADU as it complies with the City of Austin's SMART Housing program and meets at least a 3-star rating under Austin Energy's Green Building Program. The Alley Flat Initiative employs permit fee waivers from the SMART Housing program in addition to offering subsidized design and project management fees to promote the development of sustainable, green, and affordable rental accessory dwelling units (ADUs) or "Alley Flats".

The city's SMART Housing program waives development and permitting fees in exchange for a minimum 5-year commitment to rent units at affordable rates to low-income tenants. Tenants qualify if their household income is less than 80% the Austin-Round Rock MSA's median family income (MFI). Within the SMART Housing five-year affordability period, rents are limited to 28% of household income. At this moment, a 1-bedroom affordable rent is $1,005 per month, a 2-bedroom affordable rent is $1,148 per month, and a 3-bedroom affordable rent is $1,650 per month.

The Alley Flat initiative further reduces the cost of development by providing design and project management services at approximately half the market rate. Where the average cost of architectural services for a typical ADU project would cost between $7,000 and $19,000, the Alley Flat Initiative offers the service at $4,000 for a catalogue model Alley Flat and $5,000+ for a custom design.

Challenges

The potential benefits of Alley Flats have not yet been fully realized in Austin. In November 2015, Austin City council approved changes to many of the regulations that were stifling ADU development in the city. Still, many landowners who are allowed to build Alley Flats on their properties by-right face major financial barriers. While wealthier residents have easy access to financing, most low and moderate-income homeowners are unable to qualify for private financing to build an Alley Flat for a number of reasons.

1. *Debt to Income:* Federal underwriting guidelines prevent borrowers from taking loans that would cause their monthly debt burden to be greater than 35-45% of their monthly income. Until recently, these guidelines would not count rental income unless it had been stabilized for two years.
2. *Equity:* Private financing requires substantial equity or collateral to lend against. Many low-income homeowners lack the savings or home equity requirements for private lending products. Homeowners who have recently refinanced their mortgages to take advantage of historically low mortgage interest rates to consolidate their debt may have low home equity despite recent increases in property values.

3. *Credit:* Private Lenders often require at least 680 credit score to qualify for a mortgage. Prime rates typically serve borrowers with scores above 740 while those under 740 must pay higher interest rates. Due to increasing property tax burdens, low-income homeowners may have struggled to keep up with their debt payments, often times leading to foreclosures. Those low-income homeowners that continue to hold onto their homes are likely to have poor credit.

Conventional lending products fail to serve low and moderate-income residents at risk of involuntarily losing their homes. Socially conscious investors have an opportunity to intervene to overcome the opportunity gap.

Conventional Lending Products

This investigation began with a series of pro forma created to explore a number of conventional financing scenarios available for our clients in a variety of financial positions, including those with different levels of equity in their home and monthly income. First and foremost, these financial models are intended to help individual homeowners understand how an Alley Flat investment might perform over time. Second, the models help lenders understand the opportunity that Alley Flats provide in creating low-risk, stable returns. Third, the models help to understand the impact that the City of Austin's SMART Housing program and the Alley Flat Initiative's design fee subsidy has on the performance of an individuals' Alley Flat investments.

These models study Alley Flat investment strategies using four different lending products; a 1st mortgage, a construction to permanent loan package (CPerm), a cash-out refinance (Cash-out Refi), and a home equity line of credit (HELOC). Comparing these investment strategies shows that each loan products has a major effect on the performance and feasibility of an Alley Flat investment. Additionally, each product was studied using the Alley Flat Initiative program for development as well as a market rate development to estimate the effectiveness of the SMART Housing and Alley Flat Initiative affordability incentives.

Figure 1. Summary Chart: Modeled Lending Products Performance for 850 sqft Alley Flat

Financing	Size (Sqft)	Bed	Project Costs	Break Even (Year) Cash Flows to Equity	Pay-off (Year) Cash Flows to Equity & Debt	Avg. Cash-Flows/ Mo. Yr. 1 - 5 SMART Afford. Period	Avg. Cash-Flows/ Mo. Yr. 6 - 10 Market Rate	Avg. Rent / Mo. Yr. 1 - 5 SMART Afford. Period	Avg. Rent / Mo. Yr. 6 - 10 Market Rate	Debt Payment (Effective) Monthly P&I
1st Mort. SMART	850	2	$133,850	10	23	$21	$343	$1,183	$1,592	$715
1st Mort. MARKET	850	2	$141,330	7	23	$309	$307	$1,515	$1,592	$751
Cperm SMART	850	2	$133,850	10	24	$21	$343	$1,183	$1,592	$715
Cperm MARKET	850	2	$141,330	6	23	$309	$307	$1,515	$1,592	$751
Cash-out Refi SMART	850	2	$140,850	30	30	$299	$620	$1,183	$1,592	$433
Cash-out Refi MARKET	850	2	$148,330	30	30	$653	$651	$1,515	$1,592	$403
HELOC SMART	850	2	$141,580	4	28	$164	$443	$1,183	$1,592	$602
HELOC MARKET	850	2	$141,580	2	26	$487	$443	$1,515	$1,592	$602

Analysis and Table: Kevin Howard, Alley Flat Initiative, 3/24/2016

Across all loan types, the larger the investment a client is able and willing to make, the larger the structure they can build. The more bedrooms in an Alley Flat unit, the higher potential rental income and the greater the property will generate cash flows. Also, because all properties are modeled to

appreciate at the same rate, larger units that are more expensive to build will also result in greater wealth generation over time. However, in addition to standard zoning, ADU size is limited by city regulations to less than 15% the lot size and 1,100 square feet. There are also minimum requirements for pervious surfaces and sites outside of Austin's activity corridors require on-site parking. While there is not a minimum size limit for building an Alley Flat, units smaller than 200 square feet are uncommon and likely challenged to meet SMART Housing's visitability requirements.

Overall, these pro forma models are useful in estimating what kind of mortgage products a client may qualify, which product may provide returns that best fit a client's needs, and the maximum size of Alley Flat that is both affordable to the client and allowed by zoning. While the Alley Flat Initiative developments had lower overall project costs than a market rate project of the same size, the affordable rent requirement moderately delayed the point that an ADU investment would break even in each scenario. Generally, if a client can qualify for a loan large enough to build a rentable Alley Flat and the interest rate is low enough, the investment will pay for itself.

1st Mortgage

A standard first mortgage is a conventional mortgage product that places a 1st lien on real property as collateral. 1st mortgages are the most common financing mechanism for owner occupied housing in the United States. In the case of Alley Flat development, it is required that a borrower has outright ownership of their primary residence and is creating a new loan to pay for Alley Flat development. This type of loan requires significant cash equity for a down payment, as it does not rely on home equity. While any owner that qualifies for a 1st mortgage will also qualify for a cash-out refinance, a 1st mortgage may produce a higher return on investment than a cash-out refinance because the equity investment is lower (>=5% vs. >=20% LTV). Additionally, 1st mortgages for Alley Flats pay back an investor's investment much faster than a cash-out refinance because cash flows remain modest regardless of the higher equity investment required by a cash-out refinance.

Construction to Permanent [CPerm]

A construction to permanent 1st mortgage product packages an interest only construction loan and fixed rate mortgage together to reduce the impact of debt service payments during the construction period. This is particularly helpful for rental Alley Flat development because during the construction period, borrowers will not able to collect rent. Stalling principal payments until the unit is rentable helps improve cash flow in the first year of the investment. Some lenders now offer CPerm loans with one time closing which, if the permanent loan is offered at competitive rates, can reduce the overall cost of debt.

Cash-out Refinance

A cash-out refinance allows a borrower to replace their existing mortgage with a new mortgage for more than they owe on the existing mortgage and receive a "cash-out" of the home equity they have accrued. While cash-out refinance products require greater equity, a cash-out refinance relies primarily on home equity and may require no cash. In fact, most times, closing cost can be rolled into the new loan. In Texas, state law restricts cash-out refinances to 80% of the appraised value of the property, moderately increasing the amount of home equity needed to build an Alley Flat. The capacity of a cash-out refinance is also limited by the outstanding loan balance of the existing mortgage, and the ability for the client to pay the new monthly payment regardless of new rental income from the Alley Flat. Cash-

out refinance products may be a good fit for land-rich, cash-poor clients while 1st mortgages may be better for land rich clients that have some cash available to invest. Both products require moderate pre-rent stabilized income and may not be feasible for low or very low-income clients.

Construction to Permanent Refinance [CPerm Refi]

A construction to permanent refinance 1st mortgage product replaces an existing mortgage with an interest only construction loan and fixed rate mortgage packaged together to reduce the impact of debt service payments during the construction period. This is particularly helpful for rental Alley Flat development because during the construction period, borrowers will not able to collect rent. Postponing principal payments until the unit is rentable helps improve cash flow in the first year of the investment. Some lenders now offer CPerm Refi loans with one time closing which, if the permanent loan is offered at competitive rates, can reduce the overall cost of debt.

Home Equity Line of Credit [HELOC]

A home equity line of credit is a second mortgage product that leverages a borrower's home equity as collateral. A second mortgage is layered on top of an existing mortgage and represents a second lien on the property. Many banks offer Home Equity Lines of Credit, which require no cash equity. Similar to a cash-out refinance, HELOCs are also limited to 80% the assessed value of the home. Lenders still require that borrowers have good credit and low debt to income ratios. Often times, required debt to income ratios are even lower than a typical mortgage making HELOCs less attainable for low-income homeowners. Also, these products carry a variable interest rate and are riskier for the borrower. With interest rates at historic lows, it is advantageous for homeowners to lock in financing at the current rates, making HELOCs less desirable.

However, HELOCs may be beneficial for borrowers intending to develop an Alley Flat as they may pay interest only over the draw period, improving cash flows over the 5-year SMART Housing affordability period. This would effectively reduce monthly debt service payments while rents are required to be below market rates. Once they are able to charge market rent, homeowners can move into the payback period and begin paying down their principal. Some lenders allow HELOCs to be "fixed" for a period whereby interest rates are guaranteed not to increase. Alternatively, borrowers may refinance after the draw period and consolidate their debt into a single fixed rate mortgage.

Summary

While all of these lending products can be leveraged to create cash flows and generate personal wealth over time, not all of these products are options many of our clients. Each client brings their own unique financial position attached to a unique property with different capacities for building an alley flat. As such, the lending products cannot not be compared as equal alternatives.

Conventional 1st mortgages will only serve clients with complete ownership of their property and sufficient cash for a 5-20% down payment on the totally alley flat project costs. Cash-out refinance and HELOCs will only work for clients with significant home equity but may work for clients with little cash equity. However, all conventional lending products fail to serve a large subset of our targeted client base. Low income residents who are unable to meet debt to income (DTI) requirements, clients with poor credit scores (less than 680), and homeowners without either substantial home equity or cash equity will not qualify for conventional financing. While the client base that the Alley Flat Initiative can serve is limited though conventional financing, private banks and mortgage lenders are the most

consistent and readily available sources for financing the development of affordable ADUs and remain an important tool.

Alternative Financing Solutions

Following an analysis of conventional financing options, we investigated a variety of alternative financing solutions exhibited throughout the country. The following proposals detail how funds may be made available in ways that make them more accessible for low and moderate-income homeowners to make improvements to their property. Funds to seed these programs may come from a number of sources including program related investments (PRIs) from private foundations, investment from community development financial institutions, or government programs such as Austin's homestead preservation districts.

In addition to offering grants, *program related investments (PRIs)* allow foundations to collect a reasonable return for their charitable donations to maximize their philanthropic capital. Investments can take many forms including senior and subordinated loans, loan guarantees, lines of credit, deposits, bonds, or equity stakes and have been used for a variety of causes ranging from ecosystem protection to preserving and expanding affordable housing. PRIs and their associated cost are counted against a foundation's annual payout requirements for the year of distribution. Interest or return on PRIs is considered the same as a return of a grant, increasing the payout requirement by return amount. Additionally, qualified program investments carry a number of tax benefits. For foundations, PRIs offer flexibility and leverage to accomplish their social or ecological missions. For low and moderate-income residents in central Austin, PRIs can offer opportunities that they would otherwise be denied. Foundations can offer financing mechanisms through a variety of programs designed to close the opportunity gaps built into private financing.

Austin's new *homestead preservation districts (HPDs)* offer a new funding opportunity to maintain affordable housing. The legislation passed in 2005 that created Chapter 373A, Local Government Code, intended to increase homeownership, provide affordable housing, *AND prevent the involuntary loss of homesteads by existing low and moderate-income homeowners*. However, in its current form, existing low and moderate-income homeowners in HPDs will continue to experience increasing property tax bills, while their tax dollars are reinvested in building units for new low-income residents within designated homestead preservation reinvestment zones (HPRZs). While concentrating affordable housing in reinvestment zones near services and amenities is well intentioned, it will still serve to concentrate poverty and promote residential segregation as historic residential neighborhoods will continue to become increasingly inaccessible to all but the wealthy. *This program must be amended to reinvest in existing residents at risk of involuntarily losing their homes.*

Revolving Loan fund for Construction Financing

Details: Similar to a commercial construction loan, each loan would likely have a 6-12 month term to be refinanced into a permanent loan through a conventional mortgage once a lease is signed and rental income is established. Because the term of the loans are shorter than the typical 30 year fixed rate mortgage, risk is greatly reduced and there is no need for federal securitization. Additionally, the loan fund will be infinitely renewable and grow overtime with interest. As each loan is refinanced a new loan can be originated. Recent changes to Freddie Mac underwriting guidelines *(Guide Sections 5306.1, 5102.3, 5102.4, and Chapter 5302)* allow for rents from a signed lease to be counted toward income

qualification for a loan. Previously rental incomes would have needed to be stabilized for two years. This program would close a gap in underwriting guidelines that make it impossible for lenders to consider rental income or future property value in ADU development.

Who is served: The program would serve homeowners that do not have sufficient income without the additional rental income from the ADU to qualify for conventional financing where, once the rental income of the Alley Flat is counted, they have a debt-to-income ratio that qualifies them for conventional financing.

Who is not served: This program will not serve residents with low credit scores, low equity, or those with incomes well below DTI requirements where, even with the additional rental income, they will be unable to qualify for private financing.

Precedents: Denver recently created a revolving loan fund seeded with $10 million of State and local funding to finance affordable housing projects in the city. While this fund is expected to create 600-700 units over its initial funding cycle, the investment is expected to create 1700 units within the next 16 years without additional public investment. A revolving loan for Alley Flat construction would revolve faster, rapidly growing the fund. Loans would be far smaller and therefore more flexible and resilient.

Down Payment Assistance

Details: Currently, the city offers shared appreciation 2nd mortgages to first time homebuyers. These take the form of deferred 0% int. down payment assistance loans to be paid on refinance or transfer of deed. This program gives income qualified first time homeowners the chance to live in more central locations by buying down the total loan amount and increasing their financing capacity. The city could offer this same program to income qualified existing homeowners to help finance affordable Alley Flat construction.

Who is served: Down payment assistance on a loan to finance ADU construction could make Alley Flat development feasible for the large section of moderate-income homeowners who are unable to save substantial capital for a down payment.

Who is not served: This program would still not serve especially low-income homeowners or those with bad credit.

Precedents: Austin's first time homebuyer program provides a great precedent for how a shared appreciation second mortgage could work. In the case of Alley Flat development, the program would help burdened long time homeowners afford to live in the city rather than restricting limiting this benefit to new homeowners.

Shared equity model / Community Land Trust

Details: The Homestead Preservation District legislation (H.B. 525) enables the city or a non-profit to operate a community land trust (CLT) receiving property tax exemptions. The community land trust is required to lease land and sell or lease the housing units located on the land. Often the CLT permits a 99-year ground lease to owner occupied structures on the land while the land remains in the CLT. Other times the structure and the land are not separated and the CLT residents own an equity share in the CLT land and/or home. This allows residents some ability to generate wealth through appreciation of their home while keeping the home affordable into perpetuity.

While there are many structures for a shared equity investment, the ideal model for low-income residents in Austin's Homestead Preservation Districts would include the homeowner as an equity investor. This model would empower existing residents to take part in the growing economy of the city and preserve ownership in their community. Under this model income qualified homeowners would partner with the Community Land Trust to develop an ADU in their back yard. The land trust entity would finance the construction of the ADU and the existing homeowner's land would serve as their equity investment, requiring no cash investment for the homeowner. The cash flows from the ADU structure would be shared between the CLT and the homeowner based on their equity share. In exchange for donating the ownership of their land to the community land trust, low-income homeowners could substantially reduce their property taxes and moderately increased their income while continuing to live in and own their homes. Additionally, the CLT is able to have more impact because they are not forced to pay for land costs and will be able to land bank in residential neighborhoods which tend to be more family oriented.

Who is served: This strategy is able to serve homeowners with high property tax burden and limited incomes that would like to reduce the cost of their homestead. Where these residents are likely unable to qualify for private financing due to high debt to income ratio, low credit, or lack of cash or home equity, the CLT could mean the difference between remaining in or leaving their communities.

Who is not served: The CLT strategy works for any homeowner but may not be a desirable strategy for those with the financial freedom to collect greater returns while maintaining exclusive ownership of their land.

Precedents: Guadalupe Neighborhood Development Corporation (GNDC) has successfully operated a community land trust on several properties in central East Austin, solidifying terms with all taxing jurisdictions and paving the way for future community land trusts. GNDC's properties have successfully prevented existing homeowners from involuntarily losing their homes while improving residents living conditions and providing additional units for low-income residents on the organization's __ family waiting list. Additionally, the Mueller Foundation has tested different forms of shared equity housing arrangements to preserve affordable housing stock in the Mueller Airport redevelopment project. While the Foundation's initial shared equity structure was unprepared for rapidly appreciating home values, the program has adapted its terms to be more resilient to change, ensuring its existing housing stock will remain affordable into the future. A city investment in a community land trust or shared equity program could rely on established models while increasing the program's scale and impact by enabling existing residents to invest in building homes in their communities and leveraging that investment to secure a permanent stock of affordable housing.

ACDDC

Austin Community Design and Development Center

Design Matters

Alley Flats:
A Grassroots Affordable Housing Program

Executive Summary

Austin's service workers, critical workforce and their families are increasingly being pushed out of central neighborhoods by rising rents and rapidly increasing property tax bills. Developing affordable rental Alley Flats offers the potential for low and moderate-income homeowners to share their property tax burden and increase their household income, empowering them to stay in their communities and take part in the city's growing economy.

However, the residents most at-risk of being displaced from their communities are unlikely to be served by private financing. Austin's new homestead preservation districts (HPDs) offer a new funding opportunity to maintain affordable housing. The city should *reinvest* a portion of the homestead preservation tax increment funds into a program to assist low and moderate-income homeowners in financing Alley Flat development through a series of financing programs; (1) Alley Flat construction-revolving loans (2) Down payment assistance- shared appreciation second lien- and (3) a community land trust. Public financing programs could make Alley Flat development feasible for moderate and low-income homeowners while both preserving and creating affordable units, and expanding the capacity of the city to meet its affordable housing goals.

This research was provided by Kevin Howard for the Austin Community Design and Development Center and The Alley Flat Initiative in the Spring of 2016 with support from the University of Texas Center for Sustainable Development.

Affordability in Austin

In many central Austin neighborhoods, especially in East Austin, a growing population and economy have strained the existing housing stock. Austin's service workers, critical workforce and their families are increasingly being pushed out of central neighborhoods by rising rents and rapidly increasing property tax bills.

While the city increases its efforts to promote the *creation* of affordable housing, the city must also work to *preserve* affordability for its existing long-term residents. *Creating* new affordable housing units effectively replaces the affordable homes the city has lost but fails to *maintain* affordability for existing residents rooted in their communities as they face increasing financial pressure.

The Alley Flat Initiative

At the Alley Flat Initiative, we work to make sustainable, green, and affordable accessory dwelling unit (ADU) development attainable for all homeowners. An Alley Flat is distinguished as a green, affordable ADU as it complies with the City of Austin's SMART Housing program and meets at least a 3 start rating under Austin Energy's Green Building Program. The Alley Flat Initiative employs permit fee waivers from the SMART Housing program in addition to offering subsidized design and project management fees to promote the development of sustainable, green, and affordable rental accessory dwelling units (ADUs) or "Alley Flats".

An Opportunity Gap

Austin's new homestead preservation districts (HPDs) offer a new funding opportunity to maintain affordable housing. The legislation passed in 2005 that created Chapter 373A, Local Government Code, intended to increase homeownership, provide affordable housing, *AND prevent the involuntary loss of homesteads by existing low and moderate-income homeowners*. However in its current form, existing low and moderate-income homeowners in HPDs will continue to experience increasing property tax bills, while their tax dollars are reinvested in building units for new low-income residents within designated homestead preservation reinvestment zones (HPRZs). While concentrating affordable housing in reinvestment zones near services and amenities is well intentioned, it will still serve to concentrate poverty and promote residential segregation as historic residential neighborhoods will continue to become increasingly inaccessible to all but the wealthy. *This program must be amended to reinvest in existing residents at risk of involuntarily losing their homes.*

Grass-Roots Alternative

The city has an opportunity to empower low and moderate-income homeowners to participate in Austin's growing economy while creating new affordable units and preserving the affordability of existing homesteads. Austin should *reinvest* a portion of the homestead preservation tax increment funds into a program to help low and moderate income homeowners build and rent Alley Flats on their property.

This would allow residents to remain in their communities, preserving housing affordability for existing residents through micro entrepreneurship. For low and moderate-income homeowners facing increasing

property value appraisals and stagnant or declining incomes, increasing property values represent financial liability rather than growing assets. Alley Flats provide an opportunity for homeowners investing in their home and capturing some of their property's increasing value by becoming landlords. For many households in central Austin, rental income collected from an Alley Flat could mean the difference between remaining in their homes and communities and moving away from friends, families, and social services in central Austin. In Austin's Homestead Preservation Districts, increasing Alley Flat development could help stabilize neighborhoods facing increasing displacement and tax burden while empowering residents to take part in the city's growing economy.

Alley Flats also provide new affordable rental opportunities in increasingly unaffordable and gentrifying central Austin neighborhoods. Stimulating diversification of residential neighborhoods is especially important in Austin as the city continues to struggle with a long history of physical and cultural segregation. Austin was recently named the country's most segregated large MSA by the Segregated City report from Martin Prosperity Institute. Accessory dwelling units encourage mixed income neighborhoods by providing a variety of housing options in otherwise homogeneous single family neighborhoods. While large scale investments in designated reinvestment zones are unlikely to reverse the current trends of displacement and gentrification within Austin's established neighborhoods, an *incremental grassroots investment strategy* will promote *inclusive neighborhoods with housing opportunities to serve a range of household arrangements and incomes.*

Challenges

Although Austin City Council approved changes to many of the regulations that were stifling ADU development in the city, many landowners who are allowed to build Alley Flats on their properties by-right face major financial barriers. While wealthier residents may have easy access to financing, most low and moderate income homeowners are unable to qualify for private financing to build an Alley Flat for a number of reasons.

1. *Debt to Income:* Federal underwriting guidelines prevent borrowers from taking loans that would cause their monthly debt burden to be greater than 35-45% of their monthly income. Until recently, these guidelines would not count rental income unless it had been stabilized for two years. Now Freddie Mac permits a signed lease to contribute to income qualification. However, homeowners are unlikely to have the ability to secure a lease agreement on an Alley Flat before it is built.
2. *Equity:* Private financing requires substantial equity or collateral to lend against. Many low income homeowners lack the savings or home equity requirements for private lending products. Homeowners who have recently refinanced their mortgages to take advantage of historically low mortgage interest rates to consolidate their debt may have low home equity despite recent increases in property values.
3. *Credit:* Private Lenders often require at least 680 credit score to qualify for a mortgage. Prime rates typically serve borrowers with scores above 740 while those under 740 must pay higher interest rates. Due to increasing property tax burdens, many low-income homeowners have seen increased housing cost burden (US Census Bureau, ACS 5 year Estimates). ACDDC and the Alley Flat Initiative have found that many of its low-income clients who are struggling with increasing property tax burden also suffer from poor credit scores.

Conventional lending products fail to serve low and moderate income residents at risk of involuntarily losing their homes. The city has an opportunity to intervene to overcome this increasing opportunity gap.

Solutions

In order to preserve affordability for existing homeowners, a portion of the Homestead Preservation reinvestment funds should be invested into three grassroots community reinvestment programs to reach a range of homeowners facing different levels of financial hardship.

Revolving Loan fund for Construction Financing

Details: Similar to a commercial construction loan, each loan would likely have a 6-12 month term to be refinanced into a permanent loan through a conventional mortgage once a lease is signed and rental income is established. Because the term of the loans are shorter than the typical 30 year fixed rate mortgage, risk is greatly reduced and there is no need for federal securitization. Additionally, the loan fund will be infinitely renewable and grow overtime with interest. As each loan is refinanced a new loan can be originated. Recent changes to Freddie Mac underwriting guidelines *(Guide Sections 5306.1, 5102.3, 5102.4, and Chapter 5302)* allow for rents from a signed lease to be counted toward income qualification for a loan. Previously rental incomes would have needed to be stabilized for two years. This program would close a gap in underwriting guidelines that make it impossible for lenders to consider rental income or future property value in ADU development.

Who is served: The program would serve homeowners that do not have sufficient income without the additional rental income from the ADU to qualify for conventional financing where, once the rental income of the Alley Flat is counted, they have a debt-to-income ratio that qualifies them for conventional financing.

Who is not served: This program will not serve residents with low credit scores, low equity, or those with incomes well below DTI requirements where, even with the additional rental income, they will be unable to qualify for private financing.

Precedents: Denver recently created a revolving loan fund seeded with $10 million of State and local funding to finance affordable housing projects in the city. While this fund is expected to create 600-700 units over its initial funding cycle, the investment is expected to create 1700 units within the next 16 years without additional public investment. A revolving loan for Alley Flat construction would revolve faster, rapidly growing the fund. Loans would be far smaller and therefore more flexible and resilient.

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Details: Currently, the city offers shared appreciation 2nd mortgages to first time home buyers. These take the form of deferred 0% int. down payment assistance loans to be paid on refinance or transfer of deed. This program gives income qualified first time homeowners the chance to live in more central locations by buying down the total loan amount and increasing their financing capacity. The city could offer this same program to income qualified existing homeowners to help finance affordable Alley Flat construction.

Who is served: Down payment assistance on a loan to finance ADU construction could make Alley Flat development feasible for the large section of moderate-income homeowners who are unable to save substantial capital for a down payment.

Who is not served: This program would still not serve especially low-income homeowners or those with bad credit.

Precedents: Austin's first time homebuyer program provides a great precedent for how a shared appreciation second mortgage could work. In the case of Alley Flat development, the program would help burdened long time homeowners afford to live in the city rather than restricting limiting this benefit to new homeowners.

Shared equity model / Community Land Trust

Details: The Homestead Preservation District legislation (H.B. 525) enables the city or a non-profit to operate a community land trust (CLT) receiving property tax exemptions. The community land trust is required to lease land and sell or lease the housing units located on the land. Often the CLT permits a 99 year ground lease to owner occupied structures on the land while the land remains in the CLT. Other times the structure and the land are not separated and the CLT residents own an equity share in the CLT land and/or home. This allows residents some ability to generate wealth through appreciation of their home while keeping the home affordable into perpetuity.

While there are many structures for a shared equity investment, the ideal model for low-income residents in Austin's Homestead Preservation Districts would include the homeowner as an equity investor. This model would empower existing residents to take part in the growing economy of the city and preserve ownership in their community. Under this model income qualified homeowners would partner with the Community Land Trust to develop an ADU in their back yard. The land trust entity would finance the construction of the ADU and the existing homeowner's land would serve as their equity investment, requiring no cash investment for the homeowner. The cash flows from the ADU structure would be shared between the CLT and the homeowner based on their equity share. In exchange for donating the ownership of their land to the community land trust, low-income homeowners could substantially reduce their property taxes and moderately increased their income while continuing to live in and own their homes. Additionally, the CLT is able to have more impact because they are not forced to pay for land costs and will be able to land bank in residential neighborhoods which tend to be more family oriented.

Who is served: This strategy is able to serve home owners with high property tax burden and limited incomes that would like to reduce the cost of their homestead. Where these residents are likely unable to qualify for private financing due to high debt to income ratio, low credit, or lack of cash or home equity, the CLT could mean the difference between remaining in or leaving their communities.

Who is not served: The CLT strategy works for any homeowner but may not be a desirable strategy for those with the financial freedom to collect greater returns while maintaining exclusive ownership of their land.

Precedents: Guadalupe Neighborhood Development Corporation (GNDC) has successfully operated a community land trust on several properties in central East Austin, solidifying terms with all taxing jurisdictions and paving the way for future community land trusts. GNDC's properties have successfully

prevented existing homeowners from involuntarily losing their homes while improving residents living conditions and providing additional units for low-income residents on the organization's __ family waiting list. Additionally, the Mueller Foundation has tested different forms of shared equity housing arrangements to preserve affordable housing stock in the Mueller Airport redevelopment project. While the Foundation's initial shared equity structure was unprepared for rapidly appreciating home values, the program has adapted its terms to be more resilient to change, ensuring its existing housing stock will remain affordable into the future. A city investment in a community land trust or shared equity program could rely on established models while increasing the program's scale and impact by enabling existing residents to invest in building homes in their communities and leveraging that investment to secure a permanent stock of affordable housing.

Conclusion

The City of Austin has an opportunity to allocate a portion of the Homestead Preservation District funds to reinvest in the existing low and moderate-income residents in these zones, empowering them to stay in their communities and take part in the city's growing economy. Assisting these homeowners in the development of affordable ADUs will help to share their property tax burden and increase their household income. While the residents at most risk of being displaced from their communities are unlikely to be served by private financing, there are substantial opportunities for the city to fill this gap. A publicly operated revolving loan fund, down payment assistance programs, and community land trusts could make Alley Flat development feasible for moderate and low-income homeowners while both preserving existing and creating new affordable units, meeting the City of Austin's affordable housing goals.